

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:NJD:NEW:TL-N-7018-99
RABaxer

date:

to: Chief, Examination Division - New Jersey E:1111

from: District Counsel, New Jersey

subject:

Claim for Refund

Tax Period:

This is in reply to your memorandum dated November 22, 1999 requesting our opinion on the computation of deficiency interest for the above taxable year.

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUES

1. Does the request for reconsideration of a partially disallowed claim filed on constitute a new claim?
2. Should a Form 907 be secured extending the two year period in which to bring suit?
3. At what date does interest begin to run on an underpayment, where the taxpayer reported the underpayment of tax on its return and elected to have the overpayment credited against its estimated tax liability for the succeeding taxable year, but the

Service subsequently determined a deficiency in tax for the taxable year of the purported overpayment.

FACTS

This matter had been initially received in our office on September 27, 1997. We referred the matter to Chief Counsel and a FSA was generated. We forwarded that document to you on March 6, 1998. The basic facts have not changed since the original submission and will be briefly repeated here. Taxpayer is seeking a refund of interest assessed and collected by the Internal Revenue Service (IRS) as the result of an alleged improper calculation of interest on deficiencies by the use of overpayment credits.

On [REDACTED], the Taxpayer filed its Form 1120 U.S. Corporation Income Tax Return for the taxable year ended December 31, [REDACTED] ("[REDACTED]"). While the due date for the filing of this return was [REDACTED], the Taxpayer was granted an extension to file until [REDACTED].

Upon the filing of its [REDACTED] tax return, an overpayment of \$[REDACTED] was applied to the [REDACTED] estimated tax. Given that the Taxpayer did not notify the IRS to apply this overpayment against another installment, in accordance with Rev. Rul. 84-58, it was applied against the first installment payment of the next year's estimated tax.

On [REDACTED], [REDACTED], and [REDACTED] additional assessments were made against the Taxpayer. All were paid in full by the Taxpayer. At issue is the computation of interest on the [REDACTED] and [REDACTED] assessments. The [REDACTED] assessment was for \$[REDACTED] and the [REDACTED] assessment was for \$[REDACTED]. The total of the two assessments is \$[REDACTED]. The assessment on [REDACTED] represented a recapture of a foreign tax credit under I.R.C. § 905(c) and is not at issue.

Interest on the [REDACTED] and [REDACTED] assessments was computed beginning with the [REDACTED] due date of the subsequent year's first quarterly estimated tax payment.

The FSA indicated that the underpayment interest did not begin to accrue on the [REDACTED] deficiency in tax of \$[REDACTED] prior to [REDACTED], the date the fourth installment of estimated tax for [REDACTED] was due.

Computations were performed based upon the advice in the FSA a partial disallowance was made to the claim of the taxpayer. The taxpayer's representative signed a Form 2297 for the partial claim disallowance on [REDACTED]. On [REDACTED], the

taxpayer requested reconsideration of the partial claim disallowance by the Service.

DISCUSSION

First, we agree with your analysis that the letter of [REDACTED] does not constitute a new claim. The taxpayer is merely requesting that the Service reconsider the same issue that was the basis of the original claim, the computation of interest on a deficiency. The request for reconsideration was filed prior to the expiration of the time to initiate a suit under section 6532. IRM 4516.(2) clearly indicates that such requests are not to be treated as original claims.

Since the decision in May Department Stores Co. v. United States, 36 Fed.Cl. 680 (Ct. Cl. 1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the position of the Service on this issue has been evolving and has finally resulted in the issuance of Rev. Rul. 99-40, 1999-40 IRB 1. The position of the Service on this issue is set forth below.

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer claims an overpayment on a return filed either on the original due date or an extension, and the claimed overpayment is applied in full against an installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of the installment on the part of the deficiency that is equal to or less than the claimed overpayment, and from the original due date of the return on the remainder. Re. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2nd Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid.¹ The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run.

In May Department Stores Co. v. United States, supra, the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should credit the overpayment. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed by the Service on the deficiency from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984

¹ Section 6601(a) provides "[i]f any amount of tax ... is not paid on or before the last date prescribed for payment, interest on such amount ... shall be paid for the period from such last date to the date paid."

for the first and second installments of estimated tax due for 1984. The court concluded the Service's application of the taxpayer's 1983 overpayment of the first installment did not change the fact that the government had the use of the taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, supra, the Service has reconsidered the manner in which interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency for the overpayment year from the date(s) that the overpayment is applied to the succeeding year's estimated taxes. In all situations, the estimated tax rules in effect for the tax year in which the credit elect is used determine the amount of estimated taxes due, and thus, the amount of the overpayment needed to satisfy the installments of estimated tax. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.²

For the deficiency in [REDACTED], a portion of the overpayment was applied to the first and second quarter of the succeeding year's estimated taxes. Because the remaining portion of the return overpayment exceeded the subsequently determined deficiency, interest did not begin to run for the [REDACTED] deficiency on the first or second quarter installment due dates. The balance of the overpayment was not needed to satisfy any part of the third or fourth quarter installments of estimated taxes for [REDACTED]. Any overpayment not applied to the estimated tax liabilities for [REDACTED] should be applied to the income tax liabilities for [REDACTED] as of the unextended due date of that return. Thus, the interest runs on the deficiency of \$[REDACTED] from the unextended due date of the [REDACTED] return which would be [REDACTED].

² Section 6513(d) provides that if any overpayment of income tax is, in accordance with section 6402(b), claimed as a credit against estimated tax for the succeeding year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises.

CONCLUSIONS

1. The letter dated [REDACTED] does not constitute a new claim but a reconsideration request of the partially disallowed claim dated [REDACTED].
2. Pursuant to IRM 4516.4, if this case cannot be disposed of prior to 35 days before the expiration of the time for filing suit, an agreement to extend the statutory period of limitations should be made on Form 907.
3. Interest runs on any portion of the subsequently determined deficiency which exceeds the overpayment from the original due date of the tax. Interest runs on the portion of the deficiency less than or equal to the overpayment from the date the overpayment is credited to the succeeding year's estimated taxes, or the original due date of the succeeding year's income tax return to the extent the overpayment is not needed to satisfy specific installments of estimated tax.

If you have questions regarding this memorandum, please contact Robert A. Baxer at (973) 645-2598.

MATTHEW MAGNONE
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By: /s/
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Noted:

/s/
MATTHEW MAGNONE
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cc: Assistant Regional Counsel (TL)

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